MEMORANDUM

To: U.S. Department of Education and Negotiators

From: Adam Welle and Yael Shavit, State AG Negotiators

Date: March 15, 2022

Re: Proposed Revisions to 34 C.F.R. § 668.28

We previously raised concerns (attached) that existing regulations and pending proposals concerning the 90/10 Rule at 34 C.F.R. § 668.28 require revision to ensure that institutions are not incentivized to offer predatory student loans in the form of income share agreements. ED's Issue Paper 7 proposed to alter section 668.28 to prevent institutions from counting the net present value of institutional loan debt towards the 90/10 threshold and to clarify that only actual repayments on such loans qualify towards that threshold. While we agree with this concept, we expressed concern that the revision may result in attempts by institutions to evade the regulation by offering ISAs that they will argue are not "loans" as that term is used in section 668.28(a)(5)(i). We thus asked ED to clarify within section 668.28(5) that institutional loans include ISAs extended by institutions and their owners or affiliates.

Since we submitted our comment, ED has taken recent action that supports our concerns and aligns with our proposed revision. Specifically, ED issued an announcement on March 2 that recognized the CFPB's recent order and "clarifies that [] ISAs used to finance expenses for postsecondary education are private education loans under 34 C.F.R. 601.2(b)." Thus, institutions extending ISAs "must comply with the private education loan requirements in 34 C.F.R. Part 601" relating to consumer protections and disclosures. Yet, while ED recently modified Issue Paper 7 to acknowledge ISAs, it did so by proposing a separate subsection (section 668(a)(5)(iii)) that appears to deal with ISAs independently from other institutional loans.

While we believe ED's proposal is well-intentioned, we caution against this framework and encourage ED to modify section 668(a)(5) to be clear and consistent with its recent policy statement. As that statement and our prior memo explain, ISAs are just another form of a student loan that defers payment on an enrollee's tuition and educational expenses and imposes a finance charge as a condition of receiving such credit. The policies behind disclosure obligations under TILA or state laws, lender-licensing rules, prohibitions on unfair and deceptive acts and practices applied to lenders, and state usury laws are just as (if not more) necessary for students who take out ISAs.

We thus encourage ED to reconsider our proposed language, which clarifies that the term "loans" as used in section 668.28(5)(i) includes ISAs marketed by institutions and references TILA/HEA regulations for "private education loans." This approach will prevent institutions from skirting the 90/10 rule, reduce incentives to engage in predatory lending through ISAs, and be consistent with the policies of the CFPB, other regulators, and ED itself. It will also reduce confusion as to whether both section 668.28(a)(5)(i) and section 668.28(a)(5)(iii) apply to institutional ISAs. At the very least, ED should add language to section 668(a)(5)(iii) clarifying that institutional ISAs are "loans" and must comply with federal and state lending laws even if the Department sees fit to include language in the 90/10 rule that pertains specifically to ISAs.

Proposed Revision

§ 668.28 Non-title IV revenue (90/10).

(5) ***Revenue generated from institutional aid.*** The institution may include only the following institutional aid as revenue:

(i) For institutional loans made to students and credited in full to the students' accounts at the institution, the amount of payments made on those loans by current or former students that the institution received during the fiscal year, if the loans—

(A) Are bona fide as evidenced by standalone repayment agreements between the students and the institution that are enforceable promissory notes;

(B) Are issued at intervals related to the institution's enrollment periods;

(C) Are subject to regular loan repayments and collections by the institution; and

(D) Are separate from the enrollment contracts signed by the students.

(ii) For purposes of this subsection, the term “institutional loan” means any loan, extension of credit, retail installment contract, income-share agreement, or any other agreement or instrument as defined in 12 C.F.R. § 1026.46(b)(5) and extended by the institution, its owner, or affiliate to the institution’s students. “Income-share agreement” means any agreement in which a student commits to pay a portion of their future income in exchange for money, payments, or credits applied to or on behalf of the student.

Explanation:

The AG representatives propose to add the above blue language to section 668.28(5) to ensure that all forms of institutional debt issued by schools are included in this provision, which is designed to prevent institutions from evading the 90/10 Rule by signing up students for high-cost loans that frequently default, are harmful to borrowers, and may not actually lead to actual revenue for the school. As enforcers of our state’s laws, state AGs are well aware of the creativity and deception that can be used to try to evade laws that regulate the business of lending. It is thus important for Education to apply a broad definition that applies to any instrument that may be used to shirk section 668.28. We are specifically concerned about the arrival of high-cost income-share agreements that have been increasingly used in the higher-education sector to provide financing to students without complying with consumer-finance laws. Regulators have brought enforcement actions to prevent this practice in violation of usury laws, disclosure requirements, and prohibitions on unfair and deceptive practices. *See, e.g.*, *In re Better Future Forward*, Consent Order, 2021-CFPB-0005 (CFPB Sep. 7, 2021); *In re Meratas, Inc.*, Consent Order, NMLS ID No. 2120180 (Cal. Dep’t Fin. Protection & Innovcation Aug. 5, 2021). Put simply, institutions that attempt to use ISAs in lieu of traditional institutional loans should be covered by this provision. The above additions are also necessary to ensure that Education is not incentivizing these costly and deceptive lending instruments for consumers in our respective states.